REPORTS ON PRIVATE SECTOR PROGRAMS

1. Housing Subsidies to Private Developers
   (Neighbourhood Ctte, May 1981)
   ARP/MURB/ORCLP

2. Subsidies to Private Developers
   (Board, July 1980)

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   (Neighbourhood Ctte - November 1981)

January 1983

CITY OF TORONTO
HOUSING DEPARTMENT

FILE: 1503.3

January 18, 1982

To: Neighbourhoods Committee

From: Commissioner of Housing

Subject: Housing Subsidies to Private Developers

Origin: Neighbourhoods Committee, May 5, 1981 (c38nhc82005:101)

Comments:

At its meeting of May 5, 1981, your Committee requested that I report on subsidies that are currently available to private developers when constructing similar buildings to Cityhome, and that these subsidies be compared to those available to Cityhome. In the Toronto market, this means reporting on the subsidies provided by the Ontario Rental Construction Loan Program (ORCLP) and tax reduction and deferral opportunities established by the federal government under the Multiple Unit Residential Building (MURB) provisions of the Income Tax Act. Your meeting of May 5, 1981 received my description of ORCLP, which has since been revised to offer more generous funding and repayment terms.

The federal budget introduced in the fall of 1981 terminated the MURB provisions for new projects effective December 31, 1981. Changes in the MURB regulations applicable to existing MURB projects and those started prior to December 31, 1981 make MURBs less attractive for current investors. The federal budget also announced a new subsidy program for private developers. The details of this program are not yet available.

The ORCLP is almost fully subscribed and was formally terminated at the end of 1981. As of December 17, 1981, 13,532 units were being built under ORCLP across the Province and 1319 of these were in Metro Toronto but, to the best of my knowledge, none are in the City. When the initial program target to develop half of ORCLP-sponsored units in Metro is considered, the 1319 units being built is very low.

An earlier report (E.C.R. 46, NHFL 20, Clause 8, October 14, 1980) used data from an actual project for a detailed comparison between Assisted Rental Program (ARP) subsidies to the private sector and subsidies which would be incurred by a non-profit developer. Rather than relying on data from one source, I am here using current cost estimates consistent with the restrictions of ORCLP from several projects. To facilitate data analysis, I have

developed a computer model which allows me to vary the assumptions about costs, revenues and tax implications.

The attached Technical Appendix details the specific assumptions and conclusions. This analysis is an updating of all previous work on subsidy comparisons, including that contained in my report Building Challenges.

Comparison of Subsidies

Table 3 in the Technical Appendix presents a comparison of the subsidies available to private developers and non-profit developers over the life of the ORCLP assistance. At the 55% tax rate common for MURB investors, the total private subsidy is the equivalent of a $30,669 per unit grant, compared with a non-profit building subsidy of $31,438 per unit.

The private subsidy is comprised of an ORCLP subsidy of $4,529 per unit and the MURB tax reductions and deferrals. The large tax write-offs available to a MURB investor in the first two years of operation account for almost one-half of the total subsidy to a private developer. The actual subsidy for a specific project would depend on the tax bracket of the investors. The non-profit subsidy would vary only as the interest rates or operating costs change.

The claim is often made that the Capital Cost Allowance (CCA - depreciation allowed for MURBs) does not represent a subsidy because it is repaid when a building is sold. In fact the CCA is repaid only if resale generates sufficient profits to cover the CCA. The tax saved on the CCA is the same as an interest free loan from the government until recapture of CCA. In this analysis, if all the CCA were repaid after taking full advantage of ORCLP, the total subsidy would be reduced by only $661.

If the 1319 ORCLP-sponsored units being built in Metro Toronto were built at costs comparable to the ones used in this analysis, the total subsidy for private developers would be $40,452,411. If these same units were produced by non-profit developers the total subsidy would be $41,466,722.

Subsidy Trends

After the first full year of operation, non-profit subsidies are larger and decline less quickly than private subsidies. However, because of the large initial subsidies available to a private developer, the total non-profit subsidy takes a number of years to accumulate to the same level as the private subsidies. Using the assumptions outlined in the Technical Appendix, the non-profit subsidy disappears completely as revenues eventually exceed costs,

and the private subsidy dwindles to a few hundred dollars comprised solely of an ever decreasing CCA.

The non-profit subsidy is entirely dependent on the relationship between revenue and costs and is more sensitive to this relationship than private subsidies. For instance, changing the inflation factor for operation costs from 10% to 12% and keeping all other assumptions the same (holding to an 8% annual rent adjustment) increases the total non-profit subsidy by 28%, while the total private subsidy increases less than 19%.

Prospects for ORCLP in Toronto

Although there is very little difference between the subsidies available to either type of developer, the degree of incentive offered by these subsidies to the private developer must also be considered. A negative cash flow for 14 years is a big problem when most investors expect a positive cash flow after 7 years. Addition of the tax benefits and later operating surpluses results in a net return of 9.4% on equity per year over the life of the ORCLP assistance.

The possibility of any return under ORCLP depends upon the ability to develop a project within the price restrictions of the program. The amounts which could be paid for land and construction make it unlikely that suitable development opportunities exist in the City of Toronto. The reasonable rents sought by ORCLP will guarantee substantial losses, forcing investors to rely upon tax breaks to realize any positive cash flow.

Compared with ARP, the subsidies generated by ORCLP and MURB offer little incentive for an investor. This reiterates the point raised in my report before you on May 5, 1981 that ORCLP would not prove a major factor in development decisions. Earlier terms offering a $4,200 interest free loan proved totally inadequate for projects in Toronto. Revised terms offering up to $6,000 per unit still do not produce a workable program in this city.

Recommendation:

That this report be received for information.

Commissioner

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BB
AD

TECHNICAL APPENDIX

1. Introduction

2. The Project

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1. Introduction

The following comparison of subsidies, which are available to a non-profit developer and a private developer taking advantage of the Ontario Rental Construction Loan Program (ORCLP) and the tax advantages of a Multiple Unit Residential Building (MURB) certification, uses current data gathered from several sources. The main source of subsidy data for a non-profit developer is the experience of Cityhome in project planning, development and management. Data required to estimate the subsidies received by a private developer were derived from prospectuses issued in 1981 describing offerings of interests in limited partnerships organized to own, construct and operate multiple unit residential buildings in downtown Toronto. Clayton Research Associates' study for Canada Mortgage and Housing Corporation, Tax Expenditures - Housing, published in March, 1981 also provided aggregate data.

2. The Project

The hypothetical example used in this analysis is an elevatored apartment building consisting entirely of two-bedroom apartments (82 square meters each) to be built in downtown Toronto. Although this assumption was made for convenience, and has no significant impact on the analysis, it is reasonable: all of the units in two recently completed downtown buildings are two-bedroom units and the demand for two-bedroom units is very strong in the downtown area. The assumed construction start date of this example is the summer of 1981, with completion scheduled for winter 1983.

Both a private developer and a non-profit developer operate under the same constraints. Not less than 80% of the floor space can be used for apartments and related parking, recreation, service and storage areas. The capital cost per unit cannot exceed CMHC's maximum unit price (MUP) of $62,000 established in June, 1981 for elevatored apartments in the Toronto region.

3. The Developers

i) Non-Profit

. First year subsidies are those which would be received by a municipal or private non-profit group or by a co-operative. Continued operating subsidies, however, apply only to municipal non-profit financial arrangements.

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ii) Private

Typically, the development of a MURB building is undertaken by a number of business organizations described below, and individual investors. The organizations are often wholly-owned subsidiaries of an established development company, which are separately incorporated to comply with legal restrictions. A limited partnership is formed to (a) construct, own and operate a building which qualifies as a MURB under the Income Tax Act; (b) earn income; (c) provide an opportunity for capital appreciation; and (d) take advantage of provisions of the Income Tax Act permitting tax deferrals and deductions. Investors purchase "units" (not to be confused with suites) in a limited partnership to become partners who have no control of the business. The limited partnership consists of investors and a sole general partner who has the responsibility for the business of the partnership and acts on behalf of the partners. The general partner's share in the profits of the limited partnership is restricted to a maximum of $1,000 per year. The general partner has no assets other than its interest in the limited partnership. Another business organization promotes, builds and acts as the property manager.

4. Component Costs

Table 1 - Summary of Costs

	Costs for Non-Profit Developer		Costs for Private Developer	
	Amount	Percent	Amount	Percent
Land	$12,400	20.0	$12,400	15.4
Building	37,200	60.0	37,200	46.2
Equipment & Paving	1,000	1.6	1,000	1.2
Initial Services	11,400	18.4	11,400	14.2
Cash Flow Guarantee	n/a	n/a	18,455	22.8
Total Capital Cost	$62,000	100.0	$80,455	100.0

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i) Land Costs

The land component is somewhat higher than that allocated by many private and non-profit developers. Current land prices in the City of Toronto are much higher than $12,400 per unit, but the figure which has been used is about as large as can be sustained within the MUP, so that a developer must have relatively inexpensive land available.

ii) Building Costs

Current construction cost estimates are $452/square meter which would allow construction of an 82.3 square meter two-bedroom apartment for $37,200.

The building cost is also the capital cost for income tax purposes. The Income Tax Act allows the investors in a MURB project to claim a capital cost allowance which may create or increase losses for income tax purposes. These losses may be applied against income from any source. A MURB project is depreciable at a rate of 5% per annum on a diminishing balance basis.

Building costs are assumed equal for MURB building and a non-profit building when, in fact, there is a small difference. The limited partners purchase a MURB building from a builder. Some design fees are included in the purchase price. A non-profit developer, however, includes the design fees in the initial services and not in the building costs.

iii) Equipment and Paving

The Income Tax Act also allows an annual tax deduction of 20% of the undepreciated cost of appliances, asphalt, carpeting and drapes.

The cost of equipment and paving for a private developer is usually in excess of $3,000 per suite; however, a non-profit developer would allocate $1,000 or less. To boost the amount available for land the equipment costs have been kept as low as possible while still maintaining a realistic cost.

iv) Initial Services

Initial services include mortgage insurance, interest during construction and leasing, administrative services, legal fees, landscaping, brokerage fees and an initial leasing fee. Although a non-profit developer might not incur mortgage insurance or brokerage fees (about $600 in total) and would

incur design fees as a portion of initial services, the initial services for both types of developer were assumed to be equal.

The largest component (54%) of initial services is interest during construction and leasing. Administrative services are the next largest component (30%) of initial services.

v) Cash Flow Guarantee

Although all prospectuses examined consider the cash flow guarantee as a part of initial services and consequently a capital cos the cash flow guarantee is shown separately in this analysis. The Ontario Mortgage Corporation (OMC), which is responsible for administering ORCLP, does not consider the cash flow guarantee as part of the capital cost of an ORCLP-sponsored project. The OMC considers only the costs which are incurred to construct the building when evaluating the capital costs in relation to MUPs: the cash flow guarantee is viewed as a feature of the financing of the project. If the cash flow guarantee were included in the capital cost, then the total price would be over MUPs. Without a substantial cash flow guarantee, used to offset operating losses, no ORCLP projects could be built in Toronto having the typical costs and revenues used here.

Each prospectus examined calculates the cash flow guarantee in a different way and for a different time period. The simplest version is the cumulative difference between revenue and expenditures for 5 years; the most complex is the sum of the fees for obtaining a series of mortgages and promissory notes to cover any cash flow deficiency plus the cash flow deficiency for a specified period.

The cash flow guarantee in this analysis covers the first 10 years of operation and amounts to $18,455 or 23% of the total capital costs.

"Soft costs" for this analysis are the total of the cash flow guarantee and the initial services or $29,855: 37% of total capital costs. Usually soft costs are only about 21% of total costs; however, the large negative cash flow and the length of time the cash flow guarantee is in effect raise the cash flow guarantee. Clayton Research Associates found that most MURB projects show a positive cash flow after seven years. In this analysis the negative cash flow continues for 14 years, reflecting current high interest rates as well as the lower revenues likely under ORCLP.

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5. Financing the Project

i) Non-Profit Developer

The total mortgage required is $62,000. Amortization at 19% over 35 years results in annual payments of $11,358.84; amortization at 2% over the same period results in annual payments of $2,461.44. The difference between these two payments is the maximum federal subsidy available.

ii) Private Developer

Table 2 - Financing for Private Development

	Amount	Percent
Mortgage Principal	$40,500	50.3
ORCL	6,000	7.5
Investor Equity	33,955	42.2
Total	$80,455	100.0

Amortization of $40,500 for 35 years at 19% results in annual payments of $7,419.96. The ORCL is interest free; repayment of the principal must begin in year 16 and be paid by the end of year 25.

According to the Clayton study, average investor equity is 25% of total costs (including cash flow guarantee) ; however, some of the prospectuses examined indicated that investor's equity may range to as high a proportion as this analysis assumes.

Amortization periods of 35 years are used in this analysis. The ORCL must be amortized over 25 years as a second mortgage. Amortizing the first mortgage over this shorter period would increase the operating loss, in the early years and inflate the total subsidy to private developers.

CMHC may be reluctant to insure a high ratio first mortgage. The appraised value of this project would be close to $62,000 per unit and a mortgage of $40,500 is 65% of the appraised value, the upper limit of ratios now accepted by CMHC. If a higher ratio mortgage were acceptable, the investor's equity could be reduced closer to the 25% average but the operating deficit and consequently the subsidies would be increased.

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6. Projection of Cash Flow and Tax Benefits

Table 3 - Comparison of Subsidies

	Year of Construction 1981	Year of Leasing 1982	First Full Year of Operation 1983	Year OR CL Repaid 2008
(a) Private				
1. Revenue (a)	0	3499	7558	47928
2. Costs				
Mortgage		3710	7420	7420
Operating (b)	0	1485	3267	32179
3. Operating (Deficit) Surplus	0	(1696)	(3129)	8329
4. Loss for Income Tax Purposes				
CCA	1376	1991	1861	498
Operating Loss (d)	0	1689	3114	0
Soft Costs	12333	12635	1448	0
Total	13709	16315	6423	498
5. Tax Benefit of Loss (c)	7540	8973	3533	274
6. Total Subsidy (e)	10090	11298	3533	274
7. Discounted Subsidy (f)	10090	10128	2671	7
8. Cumulative Discounted Subsidy (g)	10090	20218	22889	30669
(b) Non-Profit				
1. Revenue (a)	0	3499	7558	47928
2. Costs				
Mortgage		5679	11359	11359
Operating (b)	0	1485	3267	32179
3. Operating (Deficit) Surplus	0	(3665)	(7068)	4390
4. Total Subsidy	0	3665	7068	0
5. Discounted Subsidy (f)	0	3187	5344	0
6. Cumulative Discounted Subsidy (g)	0	3187	8531	31438

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Notes for Table 3:

(a) Rental revenue is assumed equal under both programs for analytical purposes.

Sources of revenue per suite per month:

Rent and Vacancy Loss	$480
Laundry	35
Parking	25
	$540

Revenue increases at 8% per annum. No adjustment is made for reduced revenue from geared-to-income units in the non-profit project. Rents shown are 1982 "low end of market rents" for non-profit projects in downtown Toronto.

(b) Operating costs increase at 10% per annum. Operating costs were estimated by averaging the costs in new non-profit projects under Cityhome management and costs presented in recent prospectuses for private projects.

(c) Assumes 55% tax bracket. All recent MURB prospectuses project the tax benefits for investors from Ontario at 55% of the loss for income tax purposes. The maximum tax benefit is at a 62% rate: the cumulative discounted subsidy at the 62% rate is $33,996.

(d) The operating loss equals "operating (deficit) surplus" minus the principal repayment included in the mortgage payment. Losses for tax purposes must not include principal repayment.

(e) The ORCL is included in the private subsidy. An advance of $3,000 is made at roof stage, set here at the end of one year. The discounted value of this advance is $2,550. The second advance of $3,000 is received at project completion. The present value of this advance is $2,325. The total present value of the ORCL is $4,875.

(f) Discount rate is 15%.

(g) The cumulative discounted subsidy in the year the ORCL is fully repaid is the sum of the annual discounted subsidy minus the present value of the loan repayment stream ($346). The Ontario Construction Loan Program therefore provides a subsidy equivalent to a cash grant of $4,529.

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i) Comparison of Subsidies to Non-Profit and Private Developers

The cumulative discounted subsidy for a private developer is $30,669. The cumulative discounted subsidy for a non-profit developer is $31,438.

ii) Inflation Factors and Project Viability

If the operating cost increase is more than 1.4 times the revenue increase, a project starting with the assumptions used here would never produce a positive cash flow. For example, with revenue increasing at 6% and operating costs at 8% (1.33 times revenue) a negative cash flow is produced only until year 18 while at 7% and 10% (1.42 factor) the negative cash flow decreases to year 20 and then increases dramatically.

Most projects should achieve a positive cash flow by year 7 to prove attractive to investors. The cash flow guarantee used in this analysis is excessive because a negative cash flow occurs until year 14. Most developers appear reluctant to give a cash flow guarantee beyond 5 years and some, in the most recent prospectuses examined, are given for only 3 years. The rents in these latter projects are at least double that shown in this analysis, producing higher revenues and consequently much lower operating losses. The Ontario Mortgage Corporation examines the rents to ensure affordability and marketability of units. The assumption here is that the "low end of market" rents used in a non-profit project would also be set in the private project. Subsidies could be reduced in both cases by raising rents.

The non-profit subsidy is affected by changes in the inflation rates much more than are the subsidies to the private developers. Increasing the operating cost inflator to 12% and keeping the revenue inflator at 8% increases the non-profit subsidy by $8,745 but the private subsidy is increased by only $5,785. Only the operating deficit and cash flow guarantee portion of soft costs are affected: the CCA and other soft costs remain the same.

iii) Recapture of CCA

The total CCA to the end of the year in which ORCL is repaid is $28,757. The present value of this total, should the building be sold in the year following repayment of ORCL, would be $661. The cumulative discounted CCA is $10,841. If the CCA is recaptured in the year after ORCL is repaid the subsidy inherent in the tax deferral is $10,841 minus $661 or $10,180. In fact, recapture of the CCA any time after year 15

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of a project's life creates a very small decrease in the subsidies to a private developer.

E.C. #46
NHFL 2C
Cl. 8
October 14, 1980

CITY OF TORONTO
NON-PROFIT HOUSING CORPORATION

July 18, 1980

TO: BOARD OF DIRECTORS

FROM: General Manager

SUBJECT: Subsidies to Private Developers

ORIGIN: Board Meeting of July 8, 1980

COMMENT:

At the last meeting of your Board, I was directed to report on the subsidies to private developers. In the current market, this means reporting on subsidies involved in the production of housing under the Assisted Rental Program (ARP).

The attached review and analysis of ARP and related subsidies shows that the research to date has found ARP to be a costly program which generates substantial profits for private investors at the public expense, with basically no strings attached. Virtually all studies of ARP have failed to produce truly accurate estimates of subsidies based on real project costs, including the extraordinary complex tax benefits built into these projects. Data recently made available to the Housing Department on an ARP building in the City of Toronto provide the basis for a detailed comparison between subsidies to the private sector and subsidies which would be incurred by a non-profit developer to build and operate the same project.

The evidence clearly indicates that, over the short and medium term, ARP is significantly more expensive, and that it is moderately more expensive even over the long term. This should not be taken to apply to ARP buildings everywhere, since high costs in the Toronto area necessitate larger loans and grants through ARP and compound the tax losses which contribute much of the overall subsidy - a situation which would not prevail in less expensive municipalities. Nevertheless, the building in question will not even be receiving maximum ARP benefits and yet its price exceeds the limits placed on non-profit developments. In Toronto, ARP is definitely proving to be a very expensive program.

Board of Directors July 18, 1980

Recommendation:

That this report be received for information.

Barry Rose
General Manager

Kw/as

Board of Directors July 18, 1980

A Look at Subsidies in Assisted Rental Program Projects.

The 1976 version of the Assisted Rental Program (ARP), under which units are currently being constructed, provided developers with a loan from Canada Mortgage and Housing Corporation of up to $100 per month per unit to cover the difference between costs and rents. This loan gradually decreases over a 10 year period and is interest-free for that period, accounting for a substantial subsidy. The loan then starts to accumulate interest and must start to be repaid by the 15th year of operation. Because ARP is a loan (albeit interest-free), it can generate a positive cash flow while allowing a loss to be shown for income tax purposes, providing a further subsidy through the tax system.

The Capital Cost Allowance (CCA) typically provides for a depreciation write-off against all income of 5% per year on a declining balance of the project costs. Deduction of "soft" costs -- fees, interim interest charges, landscaping etc. -- are normally taken in the first years of operation to maximize initial tax advantages. The CCA must be repaid in the event a project is sold for a profit, but no interest is payable, so subsidies are still substantial. The CCA has been promoted as an integral part of ARP.

In Ontario, the Provincial Government has also made available the Ontario Rental Construction Grant (ORCG), up to $50 per unit per month, to help offset high costs in this province.

The difficulty in estimating the subsidies in ARP buildings lies in the fact that much of the subsidy goes to the investor and not to the unit itself. The tax subsidies are dependent upon the income of the investor. A 50% tax bracket is commonly assumed. But even the Federal Finance Ministry appears unable to accurately estimate the revenue which is lost in this manner.

The Assisted Rental Program included restrictions on unit size and price (the same as under AHOP), but made no provision for rent controls or occupancy restrictions. This was a conscious decision by CMHC taken with regard for the administrative problems in checking incomes (which in fact led to the termination of such checks in the Limited Dividend Program) and because it was believed to be inappropriate to control occupancy in units being offered at market rents.

Very little data on ARP buildings and subsidies have been available to date. Most studies have been performed at the theoretical level, assuming typical costs and rents. One of the earliest studies was undertaken by the Greater Vancouver Housing

Corporation in the fall of 1977. It found that, discounting ARP figures to the present, the program required 39% higher subsidies than non-profit housing over the first 10 years of operation. Over a longer period, the ARP subsidy would reduce but non-profit units were expected to generate a "surplus" for the government.

At about the same time in 1977, the Commissioner of Planning recommended to the Committee on Neighbourhoods, Housing, Fire and Legislation that ARP not be considered assisted housing within the definitons used by the City, primarily because of the absence of controls on rents and occupancy.

Studies by the Housing Department and the Canadian Council on Social Development (CCSD) have focussed on cash flow and incentive aspects of ARP rather than subsidy costs. In-house analysis by Department staff show strong early cash flow under ARP (1976), on the order of 50% of equity, but that cash flow will be negative in later years, giving rise to concerns I have expressed publicly about the possibility of foreclosures. Over a 20-year period, overall cash flow to an investor in an ARP building was found to represent about 7.9% average annual return on equity, without considering soft costs or ORCG receipt. Similar analysis of the Graduated Payment Mortgage program predicted a very low return and minimal program take-up, which prompted me to propose, and Council to adopt, various recommendations encouraging federal and provincial incentives for private rental construction. The CCSD study, published last year, quoted from "C.A. Magazine" and found that a typical investor in an ARP building would, over 12 years, receive $38,514, back on an investment of $14,000.

Material from all of these studies can be made available to interested Board Members.

CMHC's review of ARP in 1978 was one of the few to use aggregate program data. The subsidy calculations made by CMHC ignored soft costs, regular rental losses and the ORCG and came up with an estimate of ARP/CCA subsidies equivalent to about 15% of project costs. The value to the investor of this subsidy over 16 years was the equivalent of a bond yielding 15.1% per annum.

There has not yet been any aggregate data published regarding CCA costs to the Federal Government. The annual foregone interest subsidy of ARP alone has climbed from less than $3 million in 1976 to $10 million in 1977 and $19.5 million in 1979 - $4 million more than subsidies to non-profit and co-operative projects last year. With $555 million in loans approved between 1976 and 1978, this interest subsidy will continue to increase. ORCG subsidies in 1979 were about $3 million and are estimated at $4.7 million this year.

The main failure of analyses of ARP to date has arisen from the lack of specific project data. The Housing Department has recently obtained data on one project in the City of Toronto which permit a detailed comparison of ARP and non-profit subsidies over a 12-year period, the interval over which the investor's prospectus guarantees a certain cash flow. The project is of medium size and is to be occupied late in 1980. The ARP agreement with CMHC specifies a guaranteed return on "deemed" equity of 9.5% without considering various tax breaks. The cost/revenue gap requires the full $100 per unit ARP loan and about $15 per unit ORCG. A subsidy comparison is set forth below, using actual project data to arrive at all estimates.

From this analysis, it is evident that, for a very few years, non-profit subsidies would be heavier than combined ARP and tax subsidies, but that the large tax write-offs in the earliest years of operation plus the rapidly accumulating interest deferment on the ARP loan make ARP more expensive over the full period; in fact, ARP is about half again as costly to the taxpayer than if the same unit were produced by the non-profit sector.

In present value terms, the private sector subsidy represents over $4.4 million being handed over to the builder today, compared with about $2.8 million in the non-profit program -- an even sharper difference than the 50% just cited because of the heavy initial tax write-off in the ARP arrangement. The ARP subsidies equal about 36% of project costs, far more than the averages determined by CMHC. In part, this is because of the inclusion of ORCG and soft costs here and in part it stems from much higher costs found in Toronto than are found nation-wide. This must be kept in mind in comparing ARP and non-profit subsidies, for it may well be that in less costly markets subsidies would be more similar than in Toronto.

And what happens to subsidies if the building is sold and the CCA recaptured by the Government? In that case, the CCA can properly be considered an interest-free loan. The CCA itself amount to about $3.3 million to 1990. The foregone interest on the CCA's received each year totals almost $3.8 million; the subsidy can therefore be shown to be even larger than that calculated below.

Assuming that the building does not move into a foreclosure situtation with the termination of ARP and ORCG assistance, the total level of annual subsidy will decline sharply after 1990, being composed mostly of CCA deductions which are themselves declining. However, the non-profit subsidy requirements will also fall steadily; eventually non-profit funding would generate a surplus if the trends used by the builder in his prospectus

prevailed. Even over the long term, non-profit subsidies would therefore be less than those involved in private incentives.

Comparison of ARP and Non-Profit Subsidies for

Actual Project in the City of Toronto

A. Project Data

	ARP	Non-Profit
Land Cost	$ 2,124,000	$ 2,124,000
Initial Costs	2,972,200	2,185,800 (a)
Construction Costs	6,985,613	6,985,613
Total Capital Cost	12,081,813	11,295,413 (b)
Mortgage (10 3/8%, 35 yrs.)	900,264/yr.	1,181,676/yr. (c)
Mortgage (2%, 35 yrs.)	n/a	448,654/yr.
Federal Non-Profit Subsidy Available	n/a	733,022/yr.

Notes: (a) Intitial costs are less for non-profit development because the following charges would not be paid:

mortgage insurance	$105,000
cash flow guarantee	647,400
mortgage brokerage	34,000

(b) Capital cost while less (see note (a) above) for non-profit development, is still $314,413 or 2.9% above maximum price limits allowed by CMHC for non-prof apartments in Toronto. Analysis assumes approval of project with price as shown.

(c) While capital cost is less, mortgage required is higher for non-profit construction because of absence of equit

B. Operating Projections ($)

	1979	1980	1981	1982
1. Rental Revenue (a)	0	419,089	1,292,429	1,369,975
2. Costs -				
Mortgage - ARP	0	415,836	900,264	900,264
Mortgage - N.P.	0	545,821	1,181,676	1,181,676
Operating	0	110,677	632,537	683,139
3. (Deficit) or Surplus				
ARP	0	(107,424)	(240,372)	(213,428)
Non-Profit	0	(237,409)	(521,784)	(494,840)
4. ARP Loan Receipts	0	132,840	286,715	264,258
5. ORCG Receipts	0	14,957	43,375	38,888
6. Loss for Income Tax Purposes (b)	1,647,565	1,981,214	897,367	803,932
7. Tax Benefit of Loss (c)	823,783	990,607	448,683	401,966
8. Interest Deffered on ARP Loan	0	6,366	36,773	68,005
9. Total Subsidy				
- ARP	823,783	996,973	485,456	469,971
- Non-Profit (d)	0	237,409	521,784	494,840

Notes:

(a) Rental Revenue is assumed equal under both programs for analytical purposes. ARP prospectus allows for 6% annual increase. No adjustment is made for reduced revenue from geared-to-income units.

(b) Includes rental loss, initial services, and CCA.

(c) Assumes 50% bracket.

(d) Ignores extra subsidy required for geared-to-income units, totals building subsidies only.

$\frac{3,165,715}{347,955} = 9.1$

Board of Directors July 18, 1980

	1983	1984	1985	1986	1987
1.	1,452,173	1,539,283	1,631,692	1,729,529	1,833,311
2.	900,264	900,264	900,264	900,264	900,264
	1,181,676	1,181,676	1,181,676	1,181,676	1,181,676
	737,784	796,820	860,543	929,419	1,003,742
3.	(185,875)	(157,801)	(129,115)	(100,155)	(70,695)
	(467,287)	(439,213)	(410,527)	(391,566)	(352,107)
4.	241,193	217,605	193,407	168,933	143,961
5.	34,400	29,914	25,426	20,940	16,452
6.	716,142	630,453	510,152	437,064	386,434
7.	358,071	315,227	255,076	218,532	193,218
8.	100,084	133,045	166,914	201,758	237,627
9.	458,155	448,272	421,990	420,290	430,845
	467,287	439,213	410,527	391,566	352,107

	1988	1989	1990	Total
1.	1,943,296	2,059,873	2,183,559	-
2.	900,264	900,264	900,264	-
	1,181,676	1,181,676	1,181,676	-
	1,084,039	1,170,778	1,264,429	-
3.	(41,007)	(11,169)	18,866	(1,238,175)
	(322,419)	(292,581)	(262,546)	(4,192,279)
4.	118,760	93,409	67,861	1,928,942
5.	11,965	7,478	2,991	246,786
6.	328,883	274,639	194,084	8,807,929
7.	164,415	137,320	97,042	4,403,940
8.	274,601	312,784	352,275	1,890,232
9.	439,016	450,104	449,317	6,294,172
	322,419	292,581	262,546	4,192,279

Subsidies in Assisted Rental Program Projects
Background Material

1) The report is an analysis of the federal government's Assisted Rental Program, prepared for the Non-Profit Housing Corporation.

2) Assisted Rental Program provides a loan of up to $1200 per unit per year to enable a builder to charge competitive rents. The loan is interest-free for 10 years. Ontario Rental Construction Grant provides additional grant of up to $600 per unit per year, to further reduce rents in high cost areas.

3) The Income Tax Act allows investors in Assisted Rental Program projects to write off substantial initial costs (e.g. landscaping, fees) and an annual depreciation allowance. Assisted Rental Program is used to generate positive cash flow, but, because it is a loan, does not affect losses declared on normal rental operations and allowances. Investor therefore can realize high return on equity through tax subsidies.

4) Subsidies in Assisted Rental Program buildings are generated by interest foregone on Assisted Rental Program loans, by the full amount of Ontario Rental Construction Grants, and by tax write-offs through initial cost and depreciation deductions which reduce government revenue.

5) The program is of benefit to the builder because it allows him to construct at current costs and still offer competitive rents.

6) Occupancy is not controlled in any way. Tenants are supposed to benefit equally from rent reductions made possible through the subsidies. There are, however, no controls on rent beyond first year of operation.

7) The program is of benefit to investors who can declare rental losses against all their income and reduce the amount of tax they have to pay.

8) There have been 99,619 units approved in Canada, 8,256 in Metro and 1,901 in the City of Toronto.

9) Close to 20 builders have taken advantage of the program locally, including such large developers as Greenwin, Victoria Wood and Pagebrook.

Summary of Conclusion:

1) The report says the federal government is putting more money into Assisted Rental Program, in the form of interest subsidies, than it is in providing for non-profit operating subsidies.

2) The report compares Assisted Rental Program and non-profit subsidies using an actual project example (see tables at the conclusion of the report).

3) In the example included an Assisted Rental Program building is 50 per cent more expensive than if the non-profit program had been used (excluding additional assistance necessary for geared-to-income units).

4) In a letter introducing the report Barry Rose, general manager of the non-profit housing corporation, calls Assisted Rental Program "a costly program which generates substantial profits for private investors at the public expense, with basically no strings attached".

5) On the basis of the report's example, for the Toronto market the conclusion is drawn that "Assisted Rental Program is about half again as costly to the taxpayer than if the same unit were produced by the non-profit sector".

NHC
May 5/81

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HOUSING DEPARTMENT
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requested to report back in 4 weeks.

FILE: 224.1.1

April 9, 1981

To: Neighbourhoods Committee

From: Commissioner of Housing

Subject: Ontario Rental Construction Loan Program

Origin: Neighbourhoods Committee Meeting, March 11, 1981 (c38nhc81017:40)

Comments:

At its meeting of March 11, 1981, your Committee requested that I report on the Ontario Rental Construction Loan Programs as set out in a communication from Alderman Gilbert. I trust the following will answer most questions.

Commissioner

KW/cs

Attachment

1. SUBSIDY IMPLICATIONS

The Provincial Government has allocated a total of $63 million to the Ontario Rental Construction Loan Program (ORCL). Under the terms of the program, a builder of private rental housing receives, close to the date of completion, an interest-free second mortgage loan of $4200 per unit. The loan is provided by the Ontario Mortgage Corporation (OMC).

Repayment on the loan begins in the eleventh year of building operation and continues over 15 years. At 15 per cent, the foregone interest on a maximum loan would total approximately $11,500 per unit. The present value of money paid back to the Province, taking the deferred repayment schedule into consideration, is about $500. This means that the loan is the equivalent of a $3700 capital grant.

The subsidy is compounded for developers who use both ORCL and the federal multiple unit residential building (MURB) incentives. An investor should be able to improve his cash flow with ORCL without adversely affecting his tax gains through MURB, which permit him to declare losses against income from all sources for payment of initial building charges (landscaping, various fees), as well as for any operating losses. However, it is impossible to compute the combined subsidy because there is no way of knowing how a builder will choose to use ORCL receipts: they may be used to boost investor cash flow directly or they may go wholly into rent reduction - or anything in between. Should a builder apply the ORCL against the first mortgage, he would be able to cut costs (and rents) by only $46 per unit per month, if he spread the grant equivalent over the life of the first mortgage. If he applied the full $4200 against the first mortgage, he would be able to reduce rents by just over $52 per month for 10 years and $29 per month for the 15 years thereafter.

2. PROGRAM REQUIREMENTS AND PROCEDURES

The main requirement of ORCL at this stage is that capital costs do not exceed the Maximum Unit Price (MUP) schedule used for non-profit housing. Unlike the situation with non-profit housing, however, there are no provincial appraisals to deflate MUPs according to individual project characteristics. Builders are to confirm capital costs prior to interest adjustment (about the time of completion), but there are no formal contingency procedures for dealing with projects whose costs inflate during construction and exceed prescribed limits.

ORCL applicants are to project their rents so that OMC can ensure that they are marketable: neither too low to endanger economic

feasibility, nor too high to discourage occupancy. There are no controls upon later rents.

Buildings are not to be "adult only". Where local needs warrant, units for disabled persons "should be made available" but there is no mechanism to ensure that this happens. A municipality could presumably exercise some leverage in this regard if it has the opportunity through its own approvals. Up to 15 per cent of all units are to be offered for rent supplement purposes, but again, there is no mechanism to ensure that a commitment under the Rent Supplement program is made; in Toronto, the implication is that any concessions available to assisted housing could not be extended to ORCL buildings.

To facilitate the first mortgage application process, OMC issues approvals in principle for its second mortgages. The first mortgage must be secured within 60 days of this approval in principle. A construction start must come within 60 days of issuance of final approval. All projects using this program must be started by January 1, 1982.

3. RESPONSE TO ORCL

Initially, $42 million were allocated to the program, sufficient to subsidize 10,000 rental units. It was expected that 5,000 of these would be in Metro. If one were to accept the publicity surrounding the additional $21 million allocated to the program, ORCL has been wildly successful.

In fact, at time of writing, most approvals issued have been of the preliminary variety. First mortgage approval within the allowed time is not a sure thing and, unless a development is proceeding as-of-right, it would appear that many applications are most premature: there is simply no way required approvals can be obtained and construction initiated within 60 days of final approval unless plans already conform to all existing legislation.

To date, no firm second mortgage commitments have been made in Metro. No preliminary approvals have even been made in the City, although application has been made for a single project with 738 units. I believe first mortgage insurance for this project has been approved, but it is not clear that the rent schedule (which is very high) will permit speedy provincial processing, nor that the project can secure necessary City approvals at required intervals.

Some 1419 units in Scarborough had received preliminary approval by March 11, 1981, but it is my understanding that a portion of these units have been rejected for first mortgage approval by the insurer. Application for 204 more units in Scarborough has been

received by OMC. Applications for 761 units in North York had not yet received preliminary approval by March 11th.

Of 9197 units in all of Ontario which have received some form of provincial approval or which were involved in applications before OMC on March 11, 1981, only 2918 were in Metro - with only 1419 actually approved and not all of the approvals guaranteed to start construction. This falls far short of the 50 per cent target for Metro established at the inception of ORCL.

4. PROGRAM PROSPECTS

In its effects on cash flow, ORCL is less attractive than the terminated federal Assisted Rental Program. While ORCL has some advantages in its flexibility of application by a builder and in its predictability, its overall impact is marginal when compared with the total costs of development and with more significant MURB benefits.

A two-bedroom unit which is built at the maximum price limit, with 15 per cent equity and a 15 per cent mortgage would require a rent of $780 to yield the owner only a 10 per cent return on equity. The ORCL would not even cover this return on equity if the loan were invested or treated as an amortized cost reduction. The owner could elect to "front-load" the loan so that initial costs and rents could be reduced sharply, but this would require larger rent increases later to facilitate loan repayment and to make up for less subsidy being available for rent reduction. This introduces some uncertainty into investment and mortgage approval decisions. Otherwise, the most the loan would achieve would be a drop of only 6.4 per cent in rents in the first year.

Land costs are the key to any success of ORCL. In lower cost areas, development at less than the MUP ceilings is practical and the ORCL effects are more pronounced, yielding larger proportionate reductions in costs. In higher priced areas, it can be very difficult to develop within MUP ceilings at all and the relative effect of ORCL is not that important. In Metro Toronto, development is likely only on land which has been held for some time. While much needed rental housing may be built on such sites, it will be basic in quality and high in price.

The one project for which application has been made in the City may proceed, but it is not likely that the ORCL will make any difference to plans for other projects of significant size. Although it is entirely possible that the demand pressures for rental housing will prove difficult to resist, I don't believe the ORCL will prove a major factor in development decisions.

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CITY OF TORONTO
PLANNING AND DEVELOPMENT DEPARTMENT

Peter Tomlinson 3

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Policy
December 14, 1981.

To: Neighbourhoods Committee

Subject: Tax Expenditure Implications of MURB Program

Origin: Neighbourhoods Committee, Nov. 17, 1981 (c71nhc81107:44)

Comments:

The report is submitted in response to the Committee's request for an estimate of tax expenditure associated with MURB projects in the City.

Calculation of tax expenditure associated with the MURB program will be considered in detail by the Commissioner of Housing in his forthcoming report on the Ontario Rental Construction Loan Program.

The present report is concerned only with an estimate of total tax expenditure associated with MURB approvals in the City of Toronto at current levels -- approximately 1000 units/yr.

In the first year after MURB certification, most tax expenditure results from immediate write-off of soft costs -- chiefly interest and property taxes during construction. The Nov., 1981 budget proposes elimination of this tax expenditure item by requiring capitalization of soft costs: that is they will have to be written off over a 20-year period and as taxable project income permits instead of immediately.

A representative downtown condominium MURB might have 1800 sq.ft. of floor area, and hard construction costs of $108,000 ($60 per sq.ft.). Soft costs might conservatively be estimated at $50,000 on such a unit.

Thus if soft costs are deducted in the year after certification as at present rather than over 20 years, as propcsed in the budget, the extra deduction in the first year is .95 x $50,000 = $47,500. If the investor's marginal tax rate is 50% (combined Federal and Ontario), tax revenue foregone in the first year by the two levels of government is $23,750.

In addition, there is the capital cost allowance deductibility from other income sources which will end with termination of MURB. This deduction is 5% of $108,000 for the representative project considered here, or $5,400. Again assuming a 50% marginal rate,

the first year tax expenditure associated with this item is $2,700.

Cancellation of tax breaks in the present entails some legitimate new tax deduction in the future, since deductions are in effect being deferred by the Budget reforms rather than disallowed outright. However, since it is likely to be some years before taxable income from the project itself permits use of the deferred deductions, no adjustment is made here to reflect this. Similar considerations apply to possible recapture of depreciation if projects are sold.

MURB projects also continue to generate tax expenditures over future years since capital cost allowance continues as a deduction against income from other sources. A more exhaustive analysis than that presented here would add the present value of tax expenditures in future to those of the first year, resulting in an increased estimate. The March 1981 report of Clayton Research Associates, Tax Expenditures - Housing, provided a range of estimates of the present value of future years' tax expenditures from 1981 MURB's, from 73% to 110% of current year tax expenditure resulting from capital cost allowance. However, for purposes of this report, only the first year tax expenditures associated with each year's projects will be counted.

An annual flow of MURB certifications of 1000 units/yr. will not result in 1000 units worth of tax expenditures, because some units in MURB buildings are sold to owner occupants. Only the units rented out generate tax breaks. There has been considerable uncertainty regarding the extent of owner occupancy in recently developed condominium projects; for purposes of this report, an estimate of 50-50 rental-ownership seems not unreasonable. The annual flow of City MURB units generating tax expenditures, prior to the budget, would then be 500.

In sum, the estimate of total tax expenditure is as follows:

Annual Number of Units		500
Tax Expenditure Per Unit:		
- Soft Costs	$	23,750
- Capital Cost Allowance		2,700
- Total Per Unit	$	26,450
Total Tax Expenditure Per Year:		
500 x $26,450	=	$13,225,000

Neighbourhoods Committee December 14, 1981.

Recommendation:

That this report be received for information.

Stephen G. McLaughlin,
Commissioner.

PT/fs